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AN EVALUATION OF CORPORATE GOVERNANCE STRUCTURE ON PERFORFORMANCE OF COMMERCIAL BANKS IN NIGERIA

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ABSTRACT

This study examines evaluation of corporate governance structure on performance of commercial banks in Nigeria. Both primary and secondary data were used. 20 commercial banks that operated during 2000-2013 period constitute the sampling frame. In analyzing the data, the 2SLS model and the Hausman test were used. The results show that board size had a negative impact on the performance of the selected banks while board composition did not have any significant impact on the selected banks performance. It is against this background that these recommendations were made that, board members should adhere strictly to commercial banks prudent guidelines. Besides, commercial banks should reduce the number of individuals in their board if they desire to maintain or sustain a good level of performance as well as maintaining a good investment decisions for the overall performance of commercial banking institutions in Nigeria

Keywords: Corporate governance structure, Performance, Commercial banks, Nigeria.

Introduction

Commercial banks are very crucial to economic growth of the nation for the services they provide such as financial mediation between savers and investors, credit creation and encouragement of capital accumulation. Essentially, because a bank is funded primarily by depositors, it has an obligation to ensure that the risk which depositors' funds are exposed to is minimized through an effective and efficient performance. Thus, performance of the banking industry plays a significant role in determining financial stability of the country (Bhagat and Bolton, 2007; Salazar *et al*., 2012).

Due to its role as intermediary, performance of commercial banks in Nigeria attracts considerable attention from bank regulators and monetary authorities because of the adverse implications that bank failures have on public confidence in the banking system. The attention from bank regulators was primarily based on poor financial decisions of the banks whose overall performance could lead to erosion of customers' confidence and unhealthy competition.

Prior to the current financial structure in Nigeria, there was lingering distress in the banking industry; the supervisory structures were inadequate, there were cases of official recklessness amongst the managers and the industry was notorious for gross ethical abuses and poor financial decisions. Most especially, poor corporate governance was identified as the major factors responsible for all known instances of bank distress in the country. Poor corporate governance can weaken banks potential and can pave way for financial difficulties (Uwuigbe and Egbide, 2012). Hence, it is therefore pertinent to examine the challenges facing the banking sector following corporate financial scandals, poor corporate governance, ineffective financial decisions and performance of commercial banks in Nigeria.

It is clear that the development of corporate governance in banking requires that one understand how regulation affects the principal's delegation of decision making authority and what effects this has on the behaviour of their delegated agents (Coleman and Nickolas-Biekpe, 2006). They further suggested that regulation has at least four effects on the principle regulation of decision making: the existence of regulation implies the existence of an external force, independent of the market, which affects both the owner and the manager; if the market, in which banking firms act is regulated, one can argue that the regulations aimed at the market implicitly create an external governance force on the firm; the existence of both the regulator and regulations implies that the market forces will discipline both managers and owners in a different way than that in unregulated firms; in order to prevent systemic risk, such as lender of last resort, the current banking regulation means that a second and external party is sharing the banks' risk.

From the above, the external forces affecting corporate governance in banks include not only distinctive market forces but also regulation.

Better corporate governance is supposed to lead to better corporate performance by preventing the expropriation of controlling shareholders and ensuring better decision-making. In expectation of such an improvement, the firm's value may respond instantaneously to news indicating better corporate governance. However, quantitative evidence supporting the existence of a link between the quality of corporate governance and firm performance is relatively scanty (Imam, 2006).

Black *et al*. (2003) provide empirical evidence that there is a positive correlation between corporate governance and performance, but they have no explanation about the causal relationship. Wang *et al.* (2007) obtained both negative and positive results for different corporate governance variables and Bank performance in Taiwan. Drobetz, *et al*. (2003) explored the relationship between firm-level corporate governance and firm performance. They suggest that good corporate governance leads to higher firm valuation (performance), hence, investors are willing to pay a premium, and bad corporate governance is punished in terms of valuation discounts.

Materials and Methods

The study was carried out in Lagos and Abuja, Nigeria. The study areas were chosen because of its precedence, geographical location and most of the banks have their headquarters situated in the study areas. Both primary and secondary data were used. The primary data involves a structured questionnaire, which was distributed among the top officials of the sampled banks. This is due to the framework of corporate governance and financial decisions which rested on the administrative structure of the banks. The instrument was validated using cronbach–alpha test. While the secondary data covering 2000 – 2013 was collected from the various issues of the Statement of Accounts and Annual Reports of selected banks, the Central Bank of Nigeria's Statistical Bulletin, and Nigeria Deposit Insurance Corporation's Annual Account. 20 commercial banks that operated during 2000-2013 period constitute the sampling frame.

The 2SLS model was used to evaluate the effect of corporate governance structure such as board composition, board size and ownership structure on performance measure (e.g profit) is based on the theoretical argument in the literature for endogeneity of governance variables such as ownership structure as regressors on firm performance model (Black *et al*. 2003; Bhagat and Bolton, 2007). If the corporate governance variables are not exogenous, then their estimated coefficients are not consistent and inferences about the direction of causality of the variables are not clear. The exogeneity of governance variables, in particular, board structure could be in question, as others (Demsetz, 1983) have shown that such variable and firm performance can be jointly determined.

Model specification

The model used was the 2SLS to measure the effect of corporate governance on performance and the Hausman test to test for endogeneity. Implicitly, the 2SLS model could be expressed as:

$$\mathbf{Y_i = \alpha + \beta p_i + \gamma X_i + \varepsilon_i} \text{---} \quad \mathbf{(1)}$$

Where $\mathbf{Y_i}$ is an effect outcome variable and in this study represents the performance measure for bank **i** (Profit) in a sample size **n** and $\boldsymbol{\beta}$ is the vector of observable control covariates. $\mathbf{p_i}$ is the vector of parameters to be estimated, $\boldsymbol{\gamma}$ represent the instrumented variables while the **X** represents the corresponding instrument to be estimated. Specifically, the dependent variable for the study is profit of the sampled banks while the independent variables are board size, board composition and CEO duality. Board size is measured as the total number of directors serving in a bank's board. Board composition is the ratio of outside directors to the total number of directors (i.e. number of outside directors divided by total number of directors). CEO duality exists if the CEO is also the Chairman of the Board of Directors in a company and it is measured as dummy (1 if yes, 0 otherwise).

The choice of instrumental variables is critical to the consistent estimation of the objective of the study. The choice of instrumental variables was motivated by the extant literature; additionally, all the analyses involving instrumental variables included tests for weak instruments as suggested by Stock and Yogo (2004), and the Hausman (1978) test for endogeneity. Specifically, variables such as CEO tenure and CEO age were considered as instruments in the estimation process. CEO tenure refers to the number of years the CEO has been CEO while the CEO age refers to the median director's age.

Results and Discussion

The result from the estimated equation is shown in Table 1. The Hausman test (Table 2) suggests the 2SLS estimates is appropriate for inference. From the results, the coefficient of determination (R^2) indicates that about 61% of change in performance of the banks is accounted for by the explanatory variables while the adjusted R-squared further justifies this effect. From the diagnostics, the fit of the model is good suggesting its appropriateness in evaluating the effects of corporate governance on performance of banks.

The findings of the study suggested that high board size do have negative effect on the performance of the banks. This implies that increase in the board size lead to reduction in performance indices of the banks. The results provide evidence that larger board size tends to ensure that the management control of the banks is weak. Consequently, such weakness in control generates negative influence on the managers to effectively manage the conflict of interest and personal interest and thus, unable to ensure that the managers and bank administrators strive to work for the overall improvement of the banks. The improvement is then expected to translate into reduced performance. This finding is consistent with several literature such as which argued that large boards are less effective. When a board gets too big, it becomes difficult to coordinate and for it to process and tackle strategic problems of the organization, resulting in poor performance.

However, board composition has no significant effect on performance of banks, although the coefficient is positive. CEO duality is found to be positive and significantly related to performance of banks. Duality refers to situations in which the Chief Executive Officer (CEO) position is combined with the board chair position. The CEO duality is found to be positive and significantly related to performance of banks. The result implies that the sampled banks, in the period under study, had separate persons occupying the posts of chief executive and the board chair. This has influence on the financial performance of the sampled firms and in line with the tenet of the code of corporate governance best practices of Nigeria (Kajola, 2008).

Table 1: Effects of corporate governance structures on the performance of commercial banks

	OLS		2SLS	
Variables	Coefficient	t-value	Coefficient	t-value
Board size	-0.493	-2.09**	-0.384**	-3.54
Board composition	0.695	1.58	0.843	1.64
CEO duality	0.164	1.99**	0.597**	2.33
R squared	0.61		0.65	
Adj. R squared	0.59		0.64	
F-statistics	22.05		35.76	
Second stage SSR	-	-	13.034	

Source: Data analysis, 2014

Table 2: Hausman (1978) Specification Test

	h-statistics	p-value
OLS vs 2SLS	76.99	0.000

Source: Data analysis, 2014

Conclusions

The results show that high board size would significantly reduce finance decision of the banks which could affect the overall profit in the long run. Hence, high board size is not a good way to raise the profit of commercial banks in Nigeria. The results provide evidence that larger board size tends to ensure that the management control of the banks is weak. Consequently, such weakness in control generates negative influence on the managers to effectively manage the conflict of interest and personal interest and thus, unable to ensure that the managers and bank administrators strive to work for the overall improvement of the banks.

It is against this background that these recommendations were made that, board members should adhere strictly to commercial banks prudent guidelines. Besides, commercial banks should reduce the number of individuals in their board if they desire to maintain or sustain a good level of performance as well as maintaining a good investment decisions for the overall performance of commercial banking institutions in Nigeria. Also, Portfolio selection and good management (stocks, bonds, treasury bills, mutual funds, etc.) that maximizes the investor's utility should be put in place.

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